No. 10,550

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

THOMAS H. WINGATE, as Receiver in Equity for Pacific Empire Holdings, Incorporated (a corporation of the State of Delaware),

Appellant,

vs.

PETER BERCUT, HENRI BERCUT, M. MAFFEI and L. R. ARNOLD,

Appellees.

APPELLANT'S CLOSING BRIEF.

A. J. SCAMPINI,
300 Montgomery Street, San Francisco, California,
ELLIS & STEINDORF,
111 Sutter Street, San Francisco, California,
C. T. HUBNER,
Mills Building, San Francisco, California,
IVAN CULBERTSON,
Delaware Trust Building, Wilmington, Delaware,
Attorneys for Appellant.

PERNAU-WALSH PRINTING CO., SAN FRANCISCO

Subject Index

Table of Authorities Cited

Cases

Codes and Statutes

Miscellaneous

No. 10,550

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

THOMAS H. WINGATE, as Receiver in Equity for Pacific Empire Holdings, Incorporated (a corporation of the State of Delaware),

Appellant,

vs.

PETER BERCUT, HENRI BERCUT, M. MAFFEI and L. R. ARNOLD,

Appellees.

APPELLANT'S CLOSING BRIEF.

May it please the Court:

It is conceded that the entire case is open to review of the Circuit Court of Appeals under Rules of Civil Procedure (Rule 52 (a)). In fact the appellant desires just that, knowing that a complete review of the case both as to law and facts can alone show the total disregard of fact and law by the trial judge in rendering a decision for defendants.

I.

REPLY TO THE ARGUMENTS OF APPELLEES.

The entire brief of appellee, regardless of how you look at it, is a smoke screen to justify a gigantic fraud, to legalize, under the guise of apparent legality, sophistry and skillful camouflage, an unlawful taking of practically all of the assets of a corporation, and then to accuse those endeavoring to expose it of a conspiracy by innuendo.

Appellees in paragraph 1 of their "Statement of the Case" state "that appellant's case is based entirely upon the *false assumption* that what we bought at the fair price of $35,000 was at the time worth $300,000", and then admit:

> "Certainly, if we did buy at $35,000, something that at the time was worth $300,000, such a gross inadequacy of price would have shocked the conscience of the judge who presided over the trial in the court below and would invalidate the transaction in any court, trial or appellate, on any theory. No court would have any difficulty in finding some theory of invalidation, whether Bercut was at the time of the transaction a director or not, although the fact is that he was not."

The astounding situation in this case is just exactly this—that the conscience of the trial judge was not shocked, as has been that of everyone who has knowledge of the facts of this obvious fraud and colossal swindle perpetrated by the concerted action of three persons intimately connected for many years with the corporation involved, as officers, directors, voting trustees and/or executive committee men.

REPLY TO APPELLEES' POINT (a).

PETER BERCUT WAS ONE OF THE MANAGING FIDUCIARIES OF THE HOLDING COMPANY ON JANUARY 8, 1941.

In appellees' point (a), page 5 of their brief, it is contended that Peter Bercut had never been manager of Pacific Empire Holdings Inc., Pacific Empire Corporation or Merchants Ice & Cold Storage Co.

Let us concede this for the purpose of argument, but not otherwise. He was, however, a director of all three—and a member of the executive committee of Pacific Empire Holdings Inc. The affairs of the Pacific Empire Holdings Inc. of which he was the third member of the executive committee, were managed by said executive committee, the personnel of which was Messrs. Maffei, Arnold, and Peter Bercut, three of the defendants in this action. Of the three, perhaps the two defendants Maffei and Arnold were the most active, but they fully informed and advised the third member of the committee, Peter Bercut. (R. 723.)

Management of Pacific Empire Holdings Inc. was vested in the executive committee, and full and complete minutes were prepared and signed by all three, indicating full approval by all. (R. 327-330.)

At this stage in the game, the successful business man, the Napoleon of Finance, by his own admission (R. 318), Peter Bercut, would have this Court believe that he never read the minutes, didn't know the difference between the corporations, was unaware of what was going on, and signed them simply because requested to do so. It strains the credulity of a two year old.

It is submitted that it is immaterial as to who were the "managers" individually—of course the officers were, and initiated most actions, but they did so as members of the executive committee of three, who were in turn representatives of the Board. The committee cannot shirk the responsibility to the board, nor to the stockholders, by claiming it did not hold formal meetings. Whether its meetings were formal or informal, its actions breaching its fiduciary relations with the corporation and its stockholders cannot be justified.

Shall a member of the board of directors and of the executive committee be permitted to shirk his fiduciary duties and then be heard to say he is not liable because he was not the "manager" of either of these corporations? To the contrary, doesn't he owe a duty to protest those actions which are unsound, contrary to good policy and tainted with fraud, and detrimental to the best interests of the corporation, on whose board of directors he sits?

REPLY TO APPELLEES' POINT (b).

MINUTE BOOKS OF THE VARIOUS CORPORATIONS INVOLVED ARE TO BE CONSIDERED TO ESTABLISH COURSE OF CONDUCT AND AUTHORITY OF OFFICERS, DIRECTORS AND EXECUTIVE COMMITTEE.

Appellees' point (b) under Statement of Case, states that the District Court was not bound to accept as true the "minutes" of Pacific Empire Holdings Inc. or of Pacific Empire Corporation.

The evidence will show that Mr. Maffei testified that meetings of Pacific Empire Corporation were not held (R. 274) but there is no testimony that meetings of Pacific Empire Holdings Inc. were not held (R. 288-9); failing which these minutes are *prima facie* evidence of the actions of the Board and are binding upon the trial Court. There was no evasion on the part of Maffei as to meetings of Pacific Empire Corporation. He was frank and positive that there were none, so far as he could recall.

Meetings, however noticed and held and wherever held, of a board or of an executive committee, are legal and valid if signed and approved by all directors or members of executive committee.

Delaware Corporation Law, Section ~~32~~ 81;
Civil Code of California, Section 307b.

We have just that situation in the case at bar. Whether meetings were actually held, formally or informally, and agreed upon, it is sufficient for the purpose of the statute.

REPLY TO APPELLEES' POINT (c).

THE ARGUMENT OF APPELLEES PETER BERCUT AND HENRI BERCUT THAT DEFENDANTS M. MAFFEI AND L. R. ARNOLD ARE IN REALITY ALIGNED WITH THE PLAINTIFF.

The appellees Peter Bercut and Henri Bercut have, at pages 11 to 16 of their brief, deliberately sought to confuse the Court and cloud the real issues involved in this case by dragging out a red herring and parad-

ing it before the Court as a form of conspiracy between the plaintiff, his attorneys and defendants Maffei and Arnold to get the defendant Peter Bercut. They seek to create this most false impression by extracting a few lines from a long letter written by Mr. Scampini to Mr. Culbertson (found at pages 426-433 of the Record), setting them out in their brief in an artificial order, forgetting entirely the rest of the letter which contains the real meat of the situation, and which letter, when read in its entirety shows a most sincere desire on the part of all parties concerned to protect *in full, first of all, the rights of the creditors of the Holding Company,* secondly, the rights of its stockholders, and last of all the rights of the receiver and his attorneys.

It is respectfully submitted that a reading of all the correspondence referred to will dissipate completely the wholly unwarranted innuendoes made by counsel for said appellees in their brief. This correspondence, found at pages 424 to 438 of the record, though privileged, was permitted to go into the record by Mr. Scampini, so that all of the facts might be known to the trial Court.

It should be here noted that no one can rightfully deny that on August 20, 1942, and for a long time prior thereto Pacific Empire Holdings, Inc. was insolvent. When its holdings in Merchants Ice and Cold Storage Company were transferred to defendant Peter Bercut it had nothing left of any real value. (R. 225, 884.)

The last meeting of the directors of said company had been held immediately following the stockholders' meeting of February 15, 1940. The last executive committee meeting was held on October 17, 1940. The last stockholders' meeting was held on February 15, 1940. No stockholders' meeting was held either in 1941 or 1942. The management continued to be exercised by the defendants Maffei and Arnold who, finding no assets with which to stave off creditors' claims, proceeded to pledge all the stock owned by the Holding Company in Pacific Empire Corporation with Kohler & Chase. They also pledged the stock owned by the Holding Company in California Pacific Service, Inc. (R. 884), and when these pledges were foreclosed sometime in 1942 the Holding Company found itself with no assets at all and with liabilities in excess of $300,000.00. These are the facts which undoubtedly compelled counsel for said appellees to admit at page 48 of their brief: "The record at bar shows abundant justification for the appointment of a Receiver without regard to repudiation of the Bercut deal."

This was the situation when the defendants Maffei and Arnold went to Mr. Scampini to ascertain what should be done in view of the threatened lawsuit in Delaware.

It should be emphasized here that Mr. Scampini had not been an officer, director or attorney for any of these corporations or persons since August 17, 1936, when he, in disgust over the policies of the management, sent in his written resignation which is set

forth in full in the footnotes to page 10 of said appellees' brief. *It is admitted, however, that on August 20, 1942, he was a creditor and stockholder of the Holding Company and of Pacific Empire Corporation.* Defendants Maffei and Arnold also admit that on numerous occasions Mr. Scampini had inquired of them the nature of the transaction had between them and defendant Peter Bercut on January 8, 1941, and they further admit that they had falsified to him, Mr. Scampini, as well as to the other creditors, the nature of said transaction. (See R. 894.) Director Webb Richards testified, at R. 642, that the first time he learned of the true nature of said transaction was around August 20, 1942, when he learned of it from Mr. Scampini, who in turn had been told by the defendants Maffei and Arnold.

Is it to be wondered that under such circumstances Mr. Scampini (R. 642) advised the directors of the company to consent to the appointment of a receiver? Would he have been discharging his duties as a lawyer had he, under the circumstances made known to him, advised them to oppose the appointment of a receiver or to cover up on the obvious insolvency of the company and on their own mismanagement?

These directors, as well as defendants Maffei and Arnold, were told that upon the appointment of a receiver, suit would be brought against all persons responsible for the recovery of any assets belonging in law or in equity to the company, and director Webb Richards at R. 643 testified he consented to the appointment of a receiver because, in his opinion,

as a director of the company, the company needed a receiver and also because he felt that whatever the rights of the company had against Peter Bercut *and others* should be prosecuted.

The procedure, followed in this case, for the appointment of plaintiff as receiver of the Holding Company was entirely proper and not unusual. (See 45 American Juris. on Receivers, page 101, Sec. 119 and Sec. 125, page 106.)

Upon the appointment of the receiver, and after a full investigation of all the facts, and the taking of Mr. Arnold's deposition, it became apparent that defendants Maffei and Arnold were just as responsible as defendant Peter Bercut for the loss to the Holding Company of its holdings in Merchants Ice and Cold Storage Company, and, because of this, neither the receiver nor any of his attorneys hesitated one moment to sue them and to prosecute said suit against them without restraint and to the same extent as it has been and is being prosecuted against the defendant Peter Bercut. Throughout the proceeding no favoritism has been shown and no protection has been given or promised.

The argument made by counsel for appellees Peter Bercut and Henri Bercut on this phase of their brief constitutes an indirect attack on the propriety of the appointment by the Chancery Court of the State of Delaware of plaintiff herein as receiver for Pacific Empire Holdings, Inc. In the answer filed in this cause by said appellees—the lack of capacity of

plaintiff to sue or prosecute this cause was pleaded as a special defense. (See R. 38.) In the course of the trial plaintiff and his attorney, Mr. Ivan Culbertson, were present in Court prepared to defend such capacity, but said appellees (R. 294) chose to withdraw this special plea and the trial Court, with full knowledge of all the facts and circumstances leading to his appointment, in its Finding II (R. 941), found that plaintiff was the duly appointed, qualified and acting receiver in equity for Pacific Empire Holdings, Inc.

In view of these facts and the record it ill behooves the defendant Peter Bercut to now reflect upon the propriety of the appointment of plaintiff as receiver of Pacific Empire Holdings, Inc., especially so when said receiver and his attorneys are guilty of nothing more than bringing to the attention of the proper Court all of the facts and circumstances surrounding the transaction of January 8, 1941, to the end and purpose that justice be done to all persons concerned.

It is respectfully submitted that any other conduct on the part of the receiver and his attorneys would be a dereliction of their duties to the creditors of these corporations and to their more than eight thousand stockholders. (See again 45 Am. Juris.—on Receivers, Sec. 130 and 131, pages 110 and 111 of same.)

REPLY TO APPELLEES' POINT (d).

THE PRICE PAID FOR THE SHARES OF MERCHANTS ICE DELIVERED TO BERCUT BY MAFFEI AND ARNOLD WAS SHOCKINGLY INADEQUATE.

The finding of the trial Court as to the value of the shares transferred to Peter Bercut by Maffei and Arnold is treated by the appellees as "the end of the argument" and appellant is accused of lack of candor in attacking the finding.

We frankly state that the adoption by the trial Court of the finding proposed by appellee with reference to the value of the shares of stock in question, is the most astounding and incomprehensible fact in the entire record.

There is an old saying to the effect that figures don't lie, which is particularly apropos of appellees' argument on the subject of value. Not that we intend to impute lack of veracity to the appellees, but we do wish to point out the distortion which results from their one-sided analysis of figures.

Appellees' first argument consists of a vigorous attack upon the testimony of Will F. Morrish, the only really competent and disinterested witness on this phase of the case. By quotation of selected portions of testimony of Mr. Morrish on cross-examination the appellees have insinuated the thought that Mr. Morrish was unaware of the priorities of the preferred stock in liquidation and of the arrearage in dividends on cumulative preferred stock, by reason of which the calculations of Mr. Morrish were erroneous.

We do not wish to encumber the record with a lengthy quotation from the testimony of Mr. Morrish, but we call the attention of this Court to pages 479 to 482 of the reporter's transcript where Mr. Morrish stated upon cross-examination that he based his opinion upon the liquidating value; that he had, in his calculations, eliminated over $450,000.00 from the assets of the company, in addition to which he also considered the long period of service of the company in the community and the very substantial value placed on the control of the corporation which was vested in the stock under discussion.

The witness was a banker and financier of years of experience and he very clearly indicated that he was talking not arithmetic, but practical banking and business and that his opinion of value was in the light of what would reasonably be expected to happen and not a legal analysis based upon the interpretation of legal rights.

Appellees' brief contains a summary of the testimony of their witnesses relating to the market on Merchants Ice stock. (pp. 23-24.)

That market quotations under the circumstances proven to have existed in this case are no criterion in determining the true reasonable value of the 12,495 shares of preferred and 65,863 shares of common stock turned over to Peter Bercut is clearly shown by the testimony of H. R. Baker, an investment broker and specialist called as a witness by the plaintiff. At pages 444-445 of the record he testified as follows:

"Q. From your experience in unlisted securities are you in a position to state whether or not when a majority of the stock is owned by a concern and there are occasional sales transactions on outstanding stock, whether the market for such stock and such transactions reflect the true reasonable value of those securities?

A. Not necessarily. It all depends on where the control is and what kind of a control it is and what they are doing for the outside stockholders.

Q. Where a situation exists that the transactions are very rare and only involve a small number of shares, and the purchasing power, as it were, is limited to the controlling interest, would the price at which such securities would occasionally be sold be a true reflection of the reasonable value?

A. I would say they would have no reflection on the reasonable value, unless the parties who were making the market wanted to make it such."

The appellees have made a series of balance sheet adjustments, overlooking the ultimate conclusion at which they must arrive. They start at the point where Will F. Morrish left off. They ignore the fact that Mr. Morrish already made arbitrary adjustments totaling $536,988.53 for the specific purpose of accomplishing the same result the appellees are endeavoring to accomplish, namely, to wring out any water and arrive at a knock-down price. In other words, examining the résumé of Mr. Morrish's figures, Defendant's Exhibit E (p. 471), we see that Mr. Morrish

arbitrarily and to cover possible overstatements of assets or understatement of liabilities made the following eliminations:

Item	Books	Morrish	Elimination
Land	*865,608.55	$700,000.00	$165,608.55
Buildings	1,003,302.97	750,000.00	253,302.97
Investments	26,437.40	—	26,437.40
Due from Globe	23,874.94	—	23,874.94
Def. charges	59,772.95	—	59,772.25
			$536,988.53

*Obvious misprint in transcript written $86,508.55.

The appellees then stress the testimony of Mr. Samuels, who by adjustment of the land account alone eliminated an additional $541,125.00.

Appellees then consider the testimony of W. G. Evans, who eliminated an additional $58,218.00 from the notes and accounts receivable.

If we follow appellees' argument to its logical and unavoidable conclusion we arrive at a net impairment of capital of $1,492,235.00. This conclusion is so ridiculous it must fall of its own weight. If we become ridiculous we lose credibility, and the argument of the appellees followed to logical conclusion, becomes ridiculous. We are not dealing here with some little private company circulating its balance sheet among a few stockholders and its bank. It is a public utility subject to the jurisdiction of the State Railroad Commission, having a history of over fifty years' operation. The balance sheet and statements of assets included in this record are also filed with that Commission and it is on the basis of the established and accepted value

of these assets that the rates of the corporation are set by law. The corporation on January 8, 1941 had a capital structure of $1,415,725.00, consisting of $416,-150.00 seven percent preferred stock and no par common stock having a stated value of $999,575.00, and according to certified audits referred to herein and according to the balance sheets prepared by appellees, a deficit of less than $225,000.00. With one fell swoop to write nearly $1,500,000.00 off the books upon the assumption that if the property was knocked down piecemeal to individual purchasers it would bring less than book value, is contrary to accepted business practice. The fundamental precept of all valuations of active businesses is that they should be appraised on a *going concern basis.*

Now, on the other hand, let us examine into the facts as supported by the record.

There were introduced in evidence certified balance sheets prepared after audit by Haskins & Sells and John F. Forbes. Let us just see what Mr. Forbes says about the values (p. 522):

> "Plant, Property and Equipment—The plant property and equipment are recorded on the books at the September 1, 1927, valuation determined by The American Appraisal Company, plus subsequent additions at cost and less retirements at book valuation.
>
> Land—$865,608.55.
>
> Recording the land, site of the company's plant, at the September 1, 1927, appraised valuation thereof, $865,300, resulted in a write-up of $148,-

775.26, which latter amount is shown as surplus arising from appreciation."

Now it is obvious that the foregoing simply means that on appraisal in 1927 the American Appraisal Co. appraised the land for $148,775.26 more than cost. So the land which Mr. Samuels so casually appraises for $158,100 actually cost some $715,000.00. Such a stupendous overpayment cannot be conceived, much less explained. Furthermore, we would certainly expect some comment from accountants of such standing, if such an outrageous condition existed, but we find none. Nor do we find any refusal on the part of the Railroad Commission of California to accept said valuation as the basis of determining the rates to be charged by the company for its services.

Do appellees consider the fact that Mr. Morrish already made arbitrary provision of over $536,000 to cover any over-valuations or fluctuations, which would include, among other things, a fluctuation in land value. Oh no, they nonchalantly duplicate Mr. Morrish's adjustment by taking Mr. Samuel's in addition thereto.

Let us consider here the Evans adjustment of accounts receivable. Appellees vehemently deny the Bercut sale rendered his vendor insolvent. Why then the charge-off of the vendor's account receivable? Here they are blowing hot and cold. If appellant was solvent, the account was good—if appellant was not solvent the charge-off was justified. The answer, of course, is that the account was good as long as appellant had the stock of Merchants Ice as an asset

and only so long. The write-off was justified after the Bercut sale *and because of it.*

The next item in the receivables is slightly more difficult to explain, at least for appellant. We think if candor is desired, Peter Bercut could explain why he bought $5000.00 worth of stock of Frostkraft, at the same time the Merchants wrote the Frostkraft account off the books as uncollectible. (p. 441.) Or did they? Mr. Collins of Frostkraft didn't seem to know about it. (p. 440.)

> "Q. How is that indebtedness today?
> A. Well it improved. I will put it this way: That last year we were able to keep up our current bill, and of course, we still owe for previous years freezing, part of the bill."

Finally, Mr. Evans and appellees' brief make no reference to the $26,500.00 reserve for bad accounts and the $15,000.00 reserve for contingencies which were ample provision for bad accounts if the Holding Company account was good, which it was prior to the Bercut deal.

Finally, since candor is due the Court, let us examine the comparative balance sheets at December 31, 1940, and December 31, 1941. (p. 371, Pl. Ex. 32.) This is the balance sheet prepared at the end of the first year of Bercut control. Where are any of the adjustments so vehemently argued in appellees' brief? Let us examine Exhibit for Plaintiff No. 33 (p. 374), being the balance sheet at the end of 1942, and still we find no such adjustment. How can the publication of those balance sheets be reconciled with the

claims of the appellees with respect to the necessity of such adjustments? Either the present management of Merchants Ice is misrepresenting facts or appellant's contentions are justified.

According to the balance sheet prepared for Peter Bercut at the end of 1941 (p. 371) the common stock at December 31, 1940, had an equity in substantial assets of $782,982.50 or $7.30 per share. If provisions for dividend arrearage on the outstanding preferred stock be made, the equity behind the common stock is reduced to about $3.25 per share, on which basis, of course, the preferred stock increases in value to $20.00 per share. In other words, according to the statement prepared by the Bercut management, the stock Bercut received from Maffei and Arnold had a book value at December 31, 1940, before provision for dividends in arrears, as follows:

12,495 shares	preferred at	$10.00	$124,950.00
65,683 "	common at	7.30	480,799.90

after providing for preferred dividends in arrears:

12,495 shares	preferred at	$20.00	$249,900.00
65,683 "	common at	3.20	214,054.75

Assuming, without conceding, some adjustment should be made because of possible overstatement of assets or understatement of liabilities, the adjustment in total never could equal an amount sufficient to cause the Holding Company's equity ratio of the adjustment to reduce the value of its holdings to the ridiculous sum of $35,000.00. The failure of the trial Court to consider these incontrovertible facts is an obvious mistake of fact.

Finally, we come to that most candid witness, Mr. Louis T. Samuels, "a real estate expert" (R. 643) upon whose testimony, it appears, the appellees lay so much stress for justifying the Court's finding of value.

Mr. Samuels' task was simple. He came to Court with the preconceived intent of testifying to a value of $1.00 per square foot for the property of Merchants Ice. Let us consider some additional facts. Here is the largest single parcel of private property on the San Francisco Embarcadero. Unexcelled spur track and shipping facilities, both indispensable to a cold storage plant; over three acres of ground space, occupied with specialty buildings adapted to their particular requirements; a going concern in existence for fifty years. To what does Mr. Samuels compare this consolidated operating unit? Principally to spur track property and government storage property located not down by the Merchants Ice plant, but over by Fisherman's Wharf where the government has engaged in great activity since the war. Examination of the parcels used for comparison (R. p. 660) clearly shows these facts. With only two parcels is Mr. Samuels familiar. One, with a 68-foot frontage, with a sixty-year-old building (and according to his testimony (p. 660) such a building is valueless) he sold to his brother for $10,000.00, or $145.00 a front foot. The Merchants Ice property has over 2200 feet of street frontage. (See Ex. M, p. 657.) The other property (R. 668-669) he calls a block. It had 500 feet of street frontage with 17,000 square feet of land,

improved with a cracked and obsolete building. He sold it for $14,500.00, or $290.00 a front foot. On cross-examination, he reveals that the property produced about $1500.00 a year gross income after taxes, but before insurance, maintenance, depreciation, etc. Although Mr. Samuels calls it a block it is really only a large lot approximately 130 x 130 and obviously it sold on an income basis of about 10% a year gross after taxes.

Mr. Samuels entirely ignores the plottage value of owning a single unit covering nearly three blocks improved with buildings adopted to the business. Having determined on $1.00 per foot he sticks to it through thick and thin. Yet if we consult Mr. Samuels' summary (pp. 657, 658) we find he is not unaware of going concern value, because, although in his analysis on pages 659 and 660 he considers items 2, 3, 5, 7 and 8 obsolete and almost valueless, he nevertheless appraises the improvements on those parcels for $153,000.00.

But the outstanding reflection upon the unreliability of Mr. Samuels, the paid witness of the appellees, is best shown by his conduct with respect to the photographs taken by him of some of the buildings and improvements of Merchants Ice, which photographs he brought with him to Court and exhibited them to the trial judge. At page 647 of the record, he testified as follows:

> "Q. By the way, you also had some photographs of some parts of the property taken, haven't you?

A. *I had some photographs taken only of those that are in bad condition and showing what I am stressing. I did not have any photographs taken of this one."*

And at pages 664-666 he gave the following testimony:

"Mr. Scampini. Q. Mr. Samuels, you brought some photographs here into the court. Who took those photographs?

A. Moulin is the name—Gabriel Moulin.

Q. Did you take any of the pictures yourself?

A. No.

Q. Were you there when they were taken?

A. Yes, I went with the photographer.

Q. Did you go around looking for cracks to photograph?

A. Definitely, yes.

Q. Did you go around looking at all of the buildings?

A. We went over all the buildings.

Q. Now, there are two six-story buildings on this property, aren't there?

A. Surely.

Q. You only brought pictures of one. Where is the other?

A. The other is in excellent condition.

Q. *You just took a picture of the building that looked dilapidated; is that right?*

A. *Yes.*

Q. Now, the one that is in excellent condition is located on this piece of land designated as lots 11, 12 and 14 of the American Appraisal Company; is that correct?

A. I don't know the numbers.

Q. The particular photograph of that building you did not take?

A. No.

Q. This is the one that was built with the bond issue?

A. I don't know anything about it.

Q. This is the building that is the most modern building of the lot?

A. This is the building I said was in excellent condition."

Remembering that the burden of establishing that adequate consideration was paid and that the transaction was fair in every respect, rested, in this case, upon the appellees, the acceptance by the trial Court of the testimony of Mr. Samuels as the criterion of value of Merchants Ice, in view of the unprejudiced and scientific valuations made by Mr. Morrish, the certified public accountants, the American Appraisal Company, the undisputed elements of costs, of going concern value, of control, causes us to repeat our opening premise: namely that the finding of the trial Court, in this phase of the case, constitutes the most glaring and astounding error in the whole record.

REPLY TO APPELLEES' POINT (e).

PETER BERCUT WAS A FIDUCIARY.

Appellees' point (e) in the Statement of Facts that "Peter Bercut was not a director at the time of the deal" is contrary to the evidence. (R. 262 and 267.) Witness Bercut says he wasn't after May 1, 1940, but the undisputed evidence of a disinterested party, to wit, witness Leona Keener, is that he was, until his resignation was dictated to her by Bercut

on January 29, 1941, and was dated back to March 31, 1940. (R. 674-681.) To get around this damning evidence, the witness Bercut says he orally resigned in May, 1940, but on January 29, 1941 (after the "deal" had been closed) he wanted it in writing. (R. 320-21. Testimony of Peter Bercut):

"Q. Your accountant told you to resign?

A. Yes.

* * * * * * *

Q. When did you (resign)?

A. When we started to deal on this, I told Mr. Arnold that I would like to have my resignation in writing.

Q. You mean that you told Mr. Arnold that you would like to submit your resignation in writing?

A. No, I wanted to resign, but I wanted everything in writing."

If he was so certain of his previous resignation and it was a fact, no further act was necessary. Let us examine the circumstances existing at the time the urge developed "to have it all in writing". He (Bercut) is about to close a deal with his fellow members on the executive committee to clean out the last remaining sound asset of the Pacific Empire Holdings Inc. of which he was second vice president and on whose board of directors and executive committee he sat as a part of its management. In addition he was its representative on the board of directors of Merchants Ice & Cold Storage Co. and had thereby acquired an intimate knowledge of all of its affairs. The price was to be the paltry sum of $35,000, of which $25,000 was

to be used to liquidate an indebtedness of that amount owed by the selling corporation to Merchants Ice & Cold Storage Co., and $6000 of which was to be paid to the Pacific National Bank. (R. 225.) Perhaps the enormity of the "deal", perhaps some inkling of possible suits, perhaps distrust of his fellow conspirators, occurred to him or his accountant and promoted this elaborate scheme to divest himself of his obligations, fiduciary duties and trust to the corporation and the stockholders he was about to betray.

Behind this cloak of alleged oral resignation he now seeks to hide, so as to escape a violent breach of trust on his part.

But it is not even a cloak. It is rather a transparent veil.

The question here is simply, was Peter Bercut a bona fide purchaser for value, without knowledge of the condition and affairs of these companies and of the value of the assets he was buying? Was he dealing at arm's length with the Pacific Empire Holdings Inc.?

The evidence produced at the trial of this case and in the depositions taken therein indisputably prove to the contrary. It shows that Peter Bercut sat on the board of directors of Merchants Ice & Cold Storage Co., as the representative and agent of Pacific Empire Holdings, Inc., the parent company, and as such he owed a fiduciary duty to his principal to protect its interests. This law of agency and strict accountability applies whether we concede, which we do not, that he was not a director of Pacific Em-

pire Holdings, Inc. at the time of the deal. As such agent he was dealing with his principal through its other two representatives seeking to dispose of all of the corporation assets without board meetings or authorization and without knowledge of its board. He was consummating this deal with and through his actual, or if you will, his former associates on the executive committee, and with whose past course of conduct as well as mental processes he was quite familiar. He admits he was thoroughly familiar with Merchants Ice & Cold Storage Co.; had received its financial statements and knew its problems—but would do nothing while a director to assist it or secure new accounts for it or accept the management and presidency, unless he had control represented by ownership. By his own words he discloses his motive —selfish interest. Like the robber barons of old he watched these corporations being looted by their ofcers Maffei and Arnold, passively if not actively aiding them therein, ready to pounce upon them just as soon as it was obvious they no longer had the means to meet the inevitable demands upon them.

And what do the appellees claim, as a justification for the "deal", the situation to be in December, 1940, when the negotiations commenced and on January 8, 1941, when the "deal" was closed and agent Peter Bercut owned a million-dollar concern whose existence dated back to 1890, occupying approximately three square blocks on the Embarcadero, of San Francisco, for $35,000.00? (R. 293-303.) The following are the outstanding factors which, they assert,

factually justify the necessity and fairness of the transaction:

1. Loss after depreciation for past ten years of $291,000.00. (R. 420.)

2. Insufficient cash to meet payroll. (R. 296.)

3. No further credit. (R. 296.)

4. Unpaid obligation due P. G. & E. for electricity. (R. 297.)

5. Semi-annual interest payment on bonds, $21,000.00, due April, 1941. (R. 298.)

6. Ice contract with City Ice Delivery Co. pledged. (R. 299.)

7. City and county taxes due. (R. 301.)

8. Bank of America butter claim. (R. 303-305.)

This was supposed to be the situation with reference to Merchants Ice & Cold Storage Co. under the management of Pacific Empire Holdings, Inc., which in turn controlled Merchants Ice, and itself was managed by the aforesaid three.

Although these alleged conditions are the basis upon which the appellees attempt to justify the finding of the Court to the effect that Merchants Ice was, on January 8, 1941, insolvent, that they in fact did not exist is proved by the fact that to restore the corporation to solvency and profit all that was actually required was:

1. A loan of $18,000.00 in 1942.

2. Collection of $25,000.00 owed by Pacific Empire Holdings.

3. New management.

Fundamentally the problem was lack of confidence in the management, analyzing all of Bercut's testimony, and Bercut was admittedly a participant in the management of Merchants Ice.

Now as to Pacific Empire Holdings, Inc. we find after a ten-year management of that concern by Messrs. Maffei, Arnold and Bercut, in the various capacities set forth, that it has nothing left as of the commencement of the negotiations looking toward acquisition of Merchants Ice & Cold Storage control by director Bercut, except that stock which is the subject matter of the "deal". In addition there was a judgment against the holding company in the amount of $11,942.80 obtained by the United States Government in November, 1940, as well as other liabilities, which were pressing.

REPLY TO APPELLEES' POINT (f).

IT MAKES NO DIFFERENCE WHO OPENED THE NEGOTIATIONS.

Does it make any difference who initiated the negotiations looking toward the perpetration of a fraud? Obviously Arnold and Maffei were at their wit's end, for had they now finally come to the point where they must disclose all their mal-administration or else find a friendly source who was familiar with all their activities and with whom they might make a deal without too many questions being asked and from whom they might expect protection? Who more likely than their fellow director, co-member of the executive committee, the only one familiar with their entire career

and all of their operations, and with sufficient money to handle it? The answer to their prayer was Peter Bercut. They were on the spot and he was their solution. He knew it and he drove a hard bargain in his desire to acquire control of Merchants Ice & Cold Storage Co., for as "cheap a price as possible" (R. 342), a natural adjunct to his other varied businesses. He completely forgot his duty to his principal, and his fiduciary obligations as director, executive committee man and voting trustee.

Even though the corporation was being liquidated, as the witness Bercut says, or perhaps dead, as he indicated, does it thereby lose all right to protection? Is the corpse to be rendered and torn by its own officers and directors and divided among them with impunity?

And appellees would have this Court believe that because the final act was initiated by Arnold and Maffei that whatever Peter Bercut did thereafter was excused, that his position, past and present, with these companies, should be disregarded.

II.

ARGUMENT.

The case comes to this tribunal on appeal under Rules of Civil Procedure (52 (a)) for a review of the entire case, both law and fact and on a statement of findings of fact and conclusions of law which are not only contrary to fact and evidence, as appellant has shown herein and in its opening brief, but also contrary to the law applicable thereto.

A. RESIGNATION OF DIRECTORS.

It may be conceded that in the absence of a statutory or by-law provision, that a director may resign and that such resignation may be oral, although the usual and more orderly procedure is for it to be in writing. Whatever method is adopted it must clearly show *an intent to resign.* Oral declarations do not constitute a resignation where ambiguous and where subsequent acts and declarations are entirely inconsistent with any intention to resign. Neither is loose and ambiguous language sufficient to prove a resignation.

Union National Bank of Troy v. Scott, 66 N. Y. S. 145.

Although a director may resign at any time, subject of course to a charter or statutory provision to the contrary or to which he has assented by becoming such director, he may not fraudulently resign or in an attempt to effectuate a fraud.

Evarts v. Killingworth Mfg. Co., 20 Conn. 447 at 457.

Section 4 of Article IV of the by-laws of Pacific Empire Holdings. Inc., requires that the resignation be duly accepted. (R. 74p.) In the absence of charter or statutory provisions to the contrary, as in the instant case, the resignation of a director becomes complete the moment the resignation is made to the *proper officer* or *body,* which is usually the officer or body which appointed him and it is not necessary that the resignation be accepted, or that it be entered in the corporate minutes. It, however, must be *com-*

municated to the *proper body* and there must be an evidenced intention to resign.

Plaintiff and appellant contends that it is immaterial when Bercut attempted to resign, because of (1) his inextricable connections with all of the companies; (2) his continuance as director on the board of directors of Merchants Ice & Cold Storage Co., to which he owed his election as a result of the control of the Merchants Ice by Pacific Empire Holdings, Inc.; (3) his continuance on the board of directors of Pacific National Bank of San Francisco as the representative of Pacific Empire Corporation, in turn controlled by Pacific Empire Holdings, Inc.; (4) his continuance as a proxy for shares of Pacific Empire Corporation with Maffei and Arnold after May 1, 1940, the alleged date of the oral resignation, which gave him, along with Maffei and Arnold, control of that company; (5) his continuance after said date May 1, 1940, as voting trustee of the shares of stock of Pacific Empire Holdings, Inc., the selling corporation in this "deal".

The questions concerning this point to be determined by this Court are:

(1) Did Bercut effectively resign as director at any time prior to January 8, 1941, the date of consummation of the "deal"?

And

(2) Did that make any difference, in view of his position in relation to all these companies and his continuing to serve as a representative of the sell-

ing company on the board of Merchants Ice along with Maffei and Arnold?

The cases cited by appellees under points 1 and 3 on pages 49 to 53 inclusive, which, stating general law, are incomplete in so far as they do not even remotely touch upon Delaware law and do not fit the situation here where a charter (by-law) provision is involved. Resignations involve the internal affairs of a corporation and are governed by the laws of the State of incorporation, and consequently California cases are not applicable.

Appellees' conclusion on page 53 of their brief is that because a director may resign if notice is properly given and adequately proven, and not for fraudulent purposes, therefore the "deal" of January 8, 1941, was one between the *corporation* and *a stranger, at arm's length.*

His support for this unwarranted conclusion is his own finding to that effect, which is merely chasing one's tail.

He neglects, or wilfully overlooks the situation existing in the instant case, the fiduciary relationship existing for ten years between Bercut, Arnold and Maffei in connection with these companies, the interconnecting directorates, the elaborate system of control through proxies and voting trusts; the closely allied and absolute control of management through the executive committee; and lastly, the completely overlooked and disregarded factor of trustee—*cestui que* trustee—principal and agent—relationship of

Bercut as director with Maffei and Arnold on the Merchants Ice, at the will of Pacific Empire Holdings. Inc., which they controlled as leading directors and managed as its executive committee. To have destroyed this fiduciary relationship, Bercut would have had to resign from the board of Merchants Ice as well as from all other connections with any and all of these companies, in all capacities. This he did not do and defendants have not even contended that he did.

B. DIRECTORS' DUTIES AND FIDUCIARY RELATIONSHIP.

"Directors shall exercise their powers in good faith, and with a view to the interests of the corporation."

Civil Code of California, Section 311 (General Corp. Law).

A director of a corporation occupies a fiduciary relation to it and its stockholders. His position is one of trust and he is frequently denominated a trustee and so held accountable in equity. The ordinary trust relationship of directors of a corporation and stockholders is not a matter of statutory or technical law. It springs upon the fact that directors have the control and guidance of corporate business affairs and property and hence of the property interests of the stockholders. Equity recognizes that stockholders are the proprietors of the corporate interest and are ultimately the only beneficiaries thereof. Those interests are in virtue of the law in trust

through the corporation to the directors and from that condition arises the trusteeship of the directors with the concomitant fiduciary relationship.

Italo Petroleum Corp. of Amer. v. Hannigan, 14 A. (2d) 401 (Del. 1940);

Ashman v. Miller, 101 Fed. (2d) 85 (C. C. A. 6th Cir. 1939);

Dunnett v. Arn, 71 Fed. (2d) 913 (C. C. A. 10th Cir. 1934).

Directors are called upon in disposing of the property of the corporation to obtain prices which are for the best interests of the corporation and its stockholders.

Bodell v. General Gas & Electric Corp., 15 Del. Ch. 119, 132 Atl. 442.

And directors are not only bound not to profit personally at the expense of the corporation or its stockholders, but they must save them from loss. *Idem;* and stockholders are entitled to assume that directors will be faithful to their trust.

Henderson v. Plymouth Oil Co., 16 Del. Ch. 347, 141 Atl. 197 (1928).

And the control which a block of corporation's shares carries with it is a factor to be considered in determining whether the price received therefor was a fair price. (See *Potter v. Sanitary Co. of America* (Del. Ch. 1937), 194 Atl. 87.)

And even a fair price does not justify corporate officers in making a sale if the purpose and effect thereof is to advantage themselves, either in power

or profit, to the disadvantage of the corporation they represent. (*Idem.*)

And where a director is placed on the board as a representative of another corporation as Bercut was placed on the board of Merchants Ice by Pacific Empire Holdings, Inc., to safeguard its main asset, in fact its sole asset, he is bound to act in *good faith* toward *both* corporations.

Atlantic Refining Co. v. Hodgeman, 13 Fed. (2d) 781, C. C. A. 3rd Cir. 1926.

C. DIRECTORS REPRESENTING TWO CORPORATIONS.

It has also been held that transactions between corporations having common officers and directors are *presumptively fraudulent* unless ratified by the stockholders. In the case before this Court, the controlling directors of Pacific Empire Holdings, Inc. and its executive committee, Messrs. Maffei, Arnold and Bercut, respectively its president, executive vice president and second vice president, are likewise the controlling directors of Merchants Ice and its vice president, president and director respectively. The Merchants Ice had a board of directors of five consisting of Maffei, Arnold, Bercut, Morrish and A. A. Herr. The latter was a bookkeeper employee of all the corporations involved and in which the "Big Three" dominated and controlled.

Where the same persons are directors and managers of two corporations as in the case at bar, their

dealings *interesse* are subject to close scrutiny and where the transaction is of advantage to one corporation and the directors or director personally and disadvantageous to the other corporation, it is voidable in a suit brought by stockholders.

Potter v. Sanitary Co. of America, 194 A. 87 (Del. Ch. 1937);

Cahall v. Lofland, 114 A. 224 (Del. Ch. 1921).

And where the fairness of such transactions is challenged the burden is upon those who would maintain them to show their entire fairness and where a sale is involved, the full adequacy of the consideration.

First Trust & Savings Bank v. Iowa-Wisconsin Bridge Co., 98 Fed. (2d) 416 (C. C. A. 8th, 1938).

D. DIRECTORS—DEALINGS WITH CORPORATION.

Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests. Although technically not trustees, they stand in a fiduciary relation to the corporation and its stockholders. In fact a public policy, existing through the years, and no doubt derived from a profound appreciation of human characteristics, frailties and motives, has established a restatement of the old Biblical rule (that one may not serve two masters), by demanding of a corporate officer or director, or agent or proxy or voting trustee, peremptorily and inexorably, the most scrupulous ob-

servance of his duty, not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage or of its assets at grossly inadequate values. Such a rule that requires an undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self interest. In this case before this Court, we have duty kicked overboard and self interest in full control and attempted to be justified upon a theory of a course of past conduct on the part of his associates Maffei and Arnold, the other two members of the controlling triumvirate. While the occasions for the determination of *honesty, good faith* and *loyal conduct* may be many and varied and no hard and fast rule can be laid down, can it be said with a clear conscience that any element of honesty, good faith and loyal conduct, by whatever standard measured, is present in this case?

For a measure of such standards of loyalty required, see *Guth v. Loft Inc.,* 5 A. (2d) 503 (Del. Ch. 1939), already covered at length in appellant's and plaintiff's opening brief. We must keep in mind that the board in addition to the "triumvirate" consisted of A. A. Herr, a bookkeeper employee, T. M. Ryerson, a manager employee of a wholly owned subsidiary, California Pacific Service Inc. operating a laundry in Fresno, where he resided, Luigi Giachinni, a farmer living out of the city, and Webb Richards,

employee of an Oakland stock brokerage concern. Had such a board so constituted ratified the act it would have been illegal.

E. DIRECTORS—MISMANAGEMENT BY.

Directors are personally liable for gross inattention and negligence permitting fraud or misconduct on the part of agents, officers, co-directors under their control, which could have been prevented if they had given ordinary care and attention to their duties.

McGinnis v. Corporation Funding & Finance Co., 8 Fed. (2d) 532.

It is submitted that the trial Court in exonerating Maffei and Arnold along with Bercut completely disregarded the law and the fact and sanctioned the most colossal piece of corporate mismanagement and fraud that has been perpetrated in the west. An investment in excess of $2,500,000.00 made by ten thousand stockholders is dissipated over a ten-years' management and control by Maffei, Arnold and Bercut voting together and acting together as a fixed unit in all matters concerning that company.

To allow this decision to stand is to place a premium on corporate mismanagement and directors' dishonesty and disloyalty.

The right to sue officers and directors for mismanagement such as is evident in this case resulting in insolvency and a receivership is in the corporation

and may be enforced by the receiver for the benefit of all persons interested in the estate.

duPont v. Standard Arms Co., 9 Del. Ch. 324, 82 A. 692.

F. THE TRANSACTION IN ISSUE WAS NOT A CORPORATE ACT.

In their point 8, appellees contend in brief that having secured a favorable finding drafted by them to the effect that "Maffei and Arnold were acting within the course and scope of their authority" predicated upon ten years of unchallenged management, the sale was legally binding on the corporation. Appellees then cite a number of cases purporting to support exercise of management by user, so to speak. An examination of these authorities clearly shows that none of them are applicable to the case on appeal, for none of them stand for the principle that repetition of an act in violation of statute constitutes an abrogation of that statute or an estoppel against a receiver seeking to recover for the corporation or set aside acts so done. Neither do they announce the principle that a course of wrongdoing, or of fraudulent acts, justifies a perpetuation of such wrongdoing or fraud. To concede such a principle is to state that, so long as it goes unchallenged or is undetected, a course of conduct in corporate management contrary to law and a series of fraudulent acts makes those acts in accord with law and permits their continua-

tion as a matter of right. Such a position results in an absurdity and should merit little attention.

The case of *Joseph Greenspon's Sons v. Pecos Valley Gas Co.,* 156 Atl. 350, so heavily relied upon by appellees, merely states that where a president (not the first vice president) has been in the habit of doing lawful and proper acts for a corporation, and the company had authorized him to so act and had recognized, approved and ratified his former and similar actions, he is presumed to have such authority. It is conceded that usual employment may be evidence of the powers of an agent, and that a responsibility will be laid upon the principal for the acts of his agent done within the actual or *apparent scope of his authority;* that it is a doctrine which has come to apply to corporations as well as individuals and with the same qualifications and limitations. It must be within his ostensible authority and the laws of agency in this respect govern. It never justifies the doing of an unlawful act, a fraudulent act, an act outside ostensible authority, a disloyal act, a dishonest act or an undisclosed act for the agent's benefit resulting in a secret profit to himself and a detriment to his principal. (In this case Pacific Empire Holdings Inc.)

It must be an act in the usual course of business to be within the scope of his ostensible authority and it must be for the benefit of his principal and if not it must be lawfully ratified by him. The Delaware

law forbids the ratification of fraudulent or wrongful acts by stockholders and directors.

Guth v. Loft Inc., 5 Atl. (2d) 503 (Del. Ch. 1939).

Even a corporation organized to deal in securities may not be plundered or have the assets dissipated by its management under a so-called ostensible authority or course of conduct theory to the effect that one wrong piled upon another wrong created a right to continue piling wrong upon wrong. It is so apparent that ten years of mismanagement, even in a company organized to deal in securities, can not be said to be good management, proper management, loyal and honest management, that it seems unnecessary to comment further.

Appellees at pages 66 and 67 of their brief, give us the by-laws of Pacific Empire Holdings, Inc., relating to delegation of authority and Article VII concerning the executive committee, to the effect that action by the executive committee is subject to *immediate disaffirmance* by the board. He then points out that this wasn't done until twenty months later on August 20, 1942, and that such conduct is not immediate disaffirmance, if at all. The law does not require the performance of a useless act, and we have already pointed out in this brief that the board of directors at the time of the deal, January 8, 1941, elected February 15, 1940, consisted of:

1. M. Maffei, President
2. L. R. Arnold, Ex. V.P.
3. Peter Bercut, 2nd V.P.

} Executive Committee and Management

4. A. A. Herr, Secy.-Treas., bookeeper-employee
5. Webb Richards, Director, stock salesman
6. Luigi Giacchini, Director, farmer—never accepted or present
7. T. M. Ryerson, Director—employee subsidiary

Even if this board had been notified of the details concerning this "deal", constituted as it was, would it be reasonable to expect a disaffirmance when two of the board, Herr and Ryerson, owed the continuation of their jobs to the present management (Maffei, Arnold and Bercut) and the sixth director, Luigi Giacchini, never was called to any meeting. The last director, Webb Richards, had been interested with Arnold in trying to work out a stock or financing deal, wasn't interested particular in management, and stated he never received *full details* on the "deal" until August 20, 1942.

To disaffirm one must have knowledge and until one has knowledge there is no capacity to disaffirm. The authorities cited by appellees on this point, their brief, pages 67, 70, are inapplicable here for they involve acts by an officer adopted through acquiescence of an uncontrolled board. Such was clearly not the case with Pacific Empire Holdings, Inc., where there was a board dominated by the defendants themselves.

Sale of assets of a Delaware corporation (Appellees' Brief, pages 70-71), Section 65 (formerly 64a)

of the General Corporation Law of Delaware, provides that the directors may sell all of the assets, including good will, etc., when and as authorized by the affirmative vote of the holders of a majority of the issued and outstanding stock having voting power given at a stockholders' meeting *duly called for that purpose,* etc. Did we ever have such a stockholders' meeting called for that purpose? Of course not, even though voting control rested in the three, Maffei, Arnold and Bercut, as the proxies for the majority of outstanding voting stock. Delaware law does not permit a sale of all or substantially all corporate assets without compliance with Section 65 above noted. This deal involved substantially all, if not actually all, of the assets except the franchise of Pacific Empire Holdings, Inc., over which it had any control and in which it had any real equity.

Robinson v. Pittsburg Oil Refining Corp., 126 A. 46.

A Delaware corporation can sell assets incidental to the general transaction of its business without stockholders' approval, but not its principal assets.

Wattley v. National Drug Stores Corp., 204 N. Y. S. 254;

Greene v. Reconst. Fin. Corp., 100 Fed. (2d) 34 (C. C. A. 1st, 1938).

A Delaware corporation can only function through its board assembled in lawful meeting duly convened, and where there was neither a meeting of directors of a vendor corporation nor a resolution authorizing

a sale, it has been universally held there could be no sale; that the directors must act as a board, and not as individuals in order to bind the corporation; that neither a quorum nor a majority can act in any way other than through a duly convened meeting, and their individual consent to such a contract of sale of assets without a meeting is not the consent of the board.

U. S. Fire Apparatus Co. v. G. W. Baker Co., 95 Atl. 294;
Kessel v. Murray, 196 N. W. 591;
Mattoax Leather Co. v. Patzowsky, 80 A. 241.

Appellees' point 8 (b), pages 72 to 76, has been covered in our answer under points ~~1, 3, 4 and 5~~ hereof. As stated by the case of *Pepper v. Litton* (308 U.S. at 306-307), "The essence of the test is whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain." What are the "earmarks" of such a bargain? The mere finding of fact certainly can't be the "earmarks" to be sought, as is contended by appellees. We must go further than that and look for those earmarks upon which that astounding finding was made. A reading of the transcript of the record will not disclose them, as they do not in fact exist. If there ever was a deal conceived in fraud and born in iniquity this is it. As his innocent victim slept in confidence within his (Bercut's) arms, the deed was done. There were no arm's length transactions here —no strangers in this deal—rather the closest of inti-

mate relationships, entailing the strictest of fiduciary relations. None of the other cases cited by appellees have any bearing on the present case as this case is so obviously not an arm's length bargain.

Appellees' point 8 (c) has been already sufficiently covered by appellant's opening brief.

Appellees' point 9 has been sufficiently covered in our opening brief and this closing brief.

G. THE ARGUMENT THAT APPELLANT IS ESTOPPED BY REASON OF LACHES ON THE PART OF THE CORPORATION, ITS OFFICERS AND DIRECTORS.

At pages 56 to 61, inclusive, of their brief, the said appellees argue that because the defendants Maffei and Arnold sat back from January 8, 1941 to August 20, 1942, and permitted the defendant Peter Bercut to assume he had made a valid purchase and to build up the value of Merchants Ice, while the other direc- of the corporation remained silent, the corporation and appellant, as its receiver, ought now to be held estopped from complaining. They argue, in substance, that the failure of Maffei, Arnold and the other directors to seasonably rescind the transaction before Bercut did a lot of work constitutes laches on their part, which are imputable to plaintiff.

In support of this most strange argument they cite *Twin Lick Oil Co. v. Marbury,* 91 U.S. 587, 23 L. Ed. 328; and *Alexander v. Phillips Petroleum Co.,* 9 Cir., 130 Fed. (2d) 533 at 595.

A glance at both of these cases is sufficient to demonstrate that they do not, at all, support the contention of the appellees. In the *Twin Lick v. Marbury* case the very portion of the opinion quoted by the appellees in support of their argument specifically includes the following condition, viz.: "* * * *after the party with whom the right is optional is aware of the facts which give him that option.*" Likewise in the *Alexander v. Phillips Petroleum* case, the portion of the opinion quoted by the appellees specifically states that "*Laches will not be imputed to one who has been justifiably ignorant of the facts creating his right or cause of action, and who, therefore, has failed to assert it.*"

Let us apply the permitted exception to the case at bar and what do we find? We find that the defendants Maffei and Arnold *told none of the directors the true facts of the transaction* and, as director, Webb Richards testified at page 642 of the record, the first time he learned of the true facts was about August 20, 1942, when he learned of them from Mr. Scampini. And director Webb Richards was called as a witness by the defendants for the purpose of proving that the directors knew of the transaction.

It is uncontradicted that no directors or executive committee or stockholders' meeting was ever called or held for the purpose of discussing or authorizing or passing upon the advisability of disposing of this principal asset of the corporation. It is admitted by the defendants Maffei and Arnold that *at no time have the stockholders of the corporation ever been*

told that the stock of Merchants Ice owned by their company had been sold. It is also uncontradicted that the true facts of the transaction were kept from inquiring stockholders, creditors and even directors, until on or about August 20, 1942, when the directors were, for the first time, told the true situation. It is also uncontradicted that in the interval between January, 1941, and August 20, 1942, defendants Maffei and Arnold continued to function as the managing heads of the corporation and never even bothered to call the directors together again or to hold any annual meetings of stockholders, or to send any report to the stockholders.

How, under such circumstances, it can be argued that the corporation had corporate knowledge of the transaction of January 8, 1941, and that it is now estopped from complaining because of the laches of these two men, is beyond our comprehension.

The unsoundness, in law as well as in good morals, of this argument of the appellees is clearly demonstrated by the opinion of St. Sure, District Judge, rendered in *Blum v. Fleishhacker,* 21 Fed. Supp. 527 at 533, where this phase of the law is fully discussed by him, and at page 534 that learned judge states:

> "The evidence shows that discovery of the facts upon which the charges of fraud are based was made in 1933. The suit was filed on December 5, 1934, within the statutory period. The claim of laches is without merit. Franklin v. Mortgage Guaranty & Security Co. (C.C.A.) 57 Fed. (2d) 834, 838; Victor Oil Co. v. Drum, 184 Cal. 226, 242, 193 Pac. 243; Kelley v. Boettcher (C.C.A.) 85 Fed. 55, 62."

The same contention was made very forcibly in the case of *Loft, Inc. v. Guth,* 2 Atl. (2d) 225. After a lengthy discussion of the facts found by him bearing upon the argument (found at pages 242-245 of the opinion) the chancellor summarily brushed aside the plea of laches by stating (p. 245):

> "I shall not review those cases. It is not necessary for me to do so for this, if for no other reason, that my conclusion is that *though some of the directors* knew that Guth was interested in Pepsi, none of them, excepting possibly Masters, who was treasurer, knew that Guth was drawing upon Loft for practically the entire financing of Pepsi. *If they did know it and authorized it, they were clearly breachers of the trust confided to their keeping.* Directors, who either through friendship for the president of a corporation, or for fear of his displeasure or for any other reason, authorize him to use the corporate resources committed to their management or control for the promotion of his own personal projects, are participants in a fraud. As they have no power to authorize fraudulent acts, so they are equally devoid of power to ratify them."

At page 67 of their brief the appellees advance the novel theory that because of the *inaction of the board of directors of the holding company* for a period of eighteen months (January 8, 1941 to August 20, 1942) they are to be *deemed to have adopted the unauthorized act of their president and secretary.* Boiling this argument down to its basic ingredient it amounts to a plea of estoppel by implied ratification. And the answer to the argument is that these directors, *admittedly kept in ignorance of the transaction,*

cannot logically be held to have adopted as an act of their own something of which they knew nothing about.

The case of *Roth v. Ahrensfeld,* 27 N. E. (2d) 445 (Sup. Ct. of Illinois, 1940), cited by the appellees in support of their claim of *adoption* is clearly not in point because, as the Court there points out (page 447),

> "When the corporation, *through its disinterested officers or stockholders has been completely informed of the contract* (in this case with its own president) *over a long period of time and has not indicated its approval in any way, it may be concluded that the president's action has been adopted.*" (Citing cases.)

Clearly, the situation of the case at bar precludes the appellees from applying any doctrine of *adoption or ratification* on the strength of anything contained in the foregoing opinion of the Supreme Court of Illinois.

The same distinction is to be found in the cases of *Brown v. Crown Gold Milling Co.,* 150 Cal. 376, and *Thompson v. M. K. & T. Oil Co.,* 5 C. A. (2d) 117, both of which are cited by the appellees at pages 68 and 69 of their brief. A mere glance at these two cases will be sufficient to prove that in neither one of them can the appellees hope to find any refuge or support for the doctrine of adoption now advanced by them.

CONCLUSION.

On January 8, 1941, Merchants Ice was a going concern, operating as a public utility since 1890, and presently under the jurisdiction of the Railroad Commission of the State of California. It occupied approximately three square blocks, about three acres of ground and in excess of 1500 front feet on the Embarcadero in San Francisco, with spur track facilities. It was the oldest and one of the largest ice and cold storage plants in the west. It had suffered from a number of years of bad management and over a period of ten years, after allowing approximately $70,000 per year depreciation, had suffered a loss of $291,000. On December 31, 1940, it had total assets, after depreciation, of $2,059,524.98, subject to a bond issue of $659,000, and liabilities including said bond issue of $878,388.48, leaving a net worth of approximately $1,181,136.50 applicable to capital stock. After allowing $20.00 per share on all preferred stock outstanding, being 41,615 shares, having a par value of $10 per share and accumulated dividends of $10 per share, or a total of $832,300, there was as of December 31, 1940, a balance remaining of $348,836.50, or a value of $3.25 per share of common, and as of December 31, 1941, taken from the books of the company ten months after Bercut took over (the same valuations as to land, buildings and equipment being retained), a balance of $371,332, or $3.46 per common share. It owed some bills, and had always met them in the past, so it was not insolvent according to the accepted rules of business or law. After the "deal", the purported stupendous job of rehabilitation was

accomplished simply through receiving the $25,000 paid out of the sale price for the controlling stock to Bercut and the advancement by Bercut of $18,000 to settle the butter claim of the Bank of America. There was no showing that the Pacific National Bank was pressing the company (in fact, Mr. Gaither, president of the Pacific National Bank, testified that the loans of Merchants Ice were well secured, R. 504-505); that the P. G. & E. or the City and County of San Francisco were threatening or that the butter loss was anything other than an ordinary claim which might be expected in a large commodity warehouse business; its principal trouble was merely lack of confidence in management, which was the simplest thing to remedy. It required a cessation of plundering on the part of its board of directors and officers. Only a few new accounts were secured and yet almost immediately a continuation of the expected improvement was noted. After the outbreak of the war the year 1942 shows a phenominal jump in activity and profits. This was done, we are told, by Bercut the director, the manager, the genius, the financial wizard, who for three years as the agent of the Holding Company sat on the board of Merchants Ice like a dummy and permitted its mismanagement to continue. After three years of study of the affairs of Merchants Ice by himself and his auditor, and with complete knowledge of the Merchants Ice affairs, he buys through his fellow directors, executive committee men and close associates, 12,495 preferred shares having a par value of $124,950, and 65,863 shares of common having a book value of $3.25 per share, and

a total value of $214,054, plus accumulated dividends on the preferred shares of $124,950, all for $35,000. And this transaction is alleged to be in good faith, honest, at arm's length and for an adequate consideration.

And this Court is asked to sustain a judgment to the effect that such a transaction was fair and honest and that the judgment creditors and other creditors and more than ten thousand stockholders of the Holding Company are not entitled to complain.

This case comes to this Court on findings that are contrary to the evidence and are contrary to law. The judgment should be reversed.

Dated, San Francisco, California,
March 1, 1944.

Respectfully submitted,
A. J. SCAMPINI,
ELLIS & STEINDORF,
C. T. HUBNER,
IVAN CULBERTSON,
Attorneys for Appellant.